Before the
Federal Communications Commission
Washington, D.C. 20554

1993 Annual Access Tariff Filings	)	CC Docket No. 93-193
1994 Annual Access Tariff Filings	)	CC Docket No. 94-65

COMMENTS OF AT&T CORP.

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Pursuant to the Commission's *Notice*,[1] AT&T Corp. ("AT&T") files these comments demonstrating that certain price cap local exchange carriers' ("LECs") 1993 and 1994 tariffs reflected rates based upon unlawful return calculations, and that the suspended rates should, accordingly, be declared unlawful and refunds should be required.

INTRODUCTION AND SUMMARY

The Commission already has decided the central issue in these proceedings. In a 1995 order that was upheld by the Court of Appeals, the Commission ruled that "add-back" is "essential" to carrying out the "intended purpose" of the price cap mechanism and that an add-back requirement was "implicit" in the original 1990-91 price cap orders.[2] Consistent with that finding, the Commission should resolve these still pending investigations of price cap LECs'

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[1] *Further Comment Requested on the Appropriate Treatment of Sharing and Low-End Adjustments Made by Price Cap Local Exchange Carriers in Filing 1993 and 1994 Interstate Access Tariffs*, CC Docket Nos. 93-193, 94-65, DA 03-1101 (rel. April 7, 2003).

[2] *Bell Atlantic* v. *FCC*, 79 F.3d 1195, 1202 (D.C. Cir. 1996) (citing the Commission's conclusion that the "add-back rule had been implicit in the sharing rules from the beginning [of the price cap mechanism]").

1993 and 1994 interstate access tariffs by requiring the LECs that failed to comply with the add-back requirements to refund to rate-payers the over-earnings resulting from that unlawful conduct.

In the 1990 and 1991 price cap orders, the Commission adopted a "backstop" mechanism that required LECs to report rates-of-return to ensure that the LECs were not over- or under-earning under the new price cap mechanism. Longstanding Commission rules in place at the time of the price cap orders required LECs to compute returns using an "add back" mechanism, which obligated LECs to compute current period returns by excluding payments made (or subsidies earned) in the current period to correct for over- or under-earnings in the previous period.[3] Although add-back was quite plainly as essential to proper functioning of the price cap system as it had been under rate-of-return regulation, the Commission's price cap orders did not explicitly refer to the add-back rules.

In their 1993 and 1994 interstate access tariffs, the price cap LECs attempted a "heads we win, tails you lose" approach to the Commission's silence on the add-back issue by applying add-back when it would increase interstate access rates, but not when it would decrease rates. The LECs that benefited from applying the add-back rules argued that the price cap orders must have implicitly adopted the add-back rules because those rules are critical to properly computing returns. The LECs that benefited by not applying the add-back rules claimed that, because the

[3] *Amendment of Part 65, Interstate Rate of Return Prescription: Procedures and Methodologies to Establish Reporting Requirements*, 1 FCC Rcd. 952, 956-57 (1986) ("*Part 65 Amendment Order*"); *Amendment of Part 65, Interstate Rate of Return Prescription: Procedures and Methodologies to Establish Reporting Requirements,* 104 F.C.C.2d 273, ¶ 14 (1986) (explaining that such adjustments are necessary "so that the [rate-of return] reports accurately reflect the carrier's earnings in each period"); *see also* Notice of Proposed Rulemaking, *Price Cap Regulation of Local Exchange Carriers Rate of Return Sharing and Lower Formula Adjustment,* 8 FCC Rcd. 4415, ¶¶ 5-6 (1993) ("*1993 Add-Back NPRM*").

price cap orders do not explicitly address those rules, LECs were not authorized to apply them. The Commission suspended the LECs' 1993 and 1994 tariffs and set them for investigation to determine, among other things, whether the LECs had calculated their returns correctly.

In a separate rulemaking proceeding, the Commission definitively resolved the add-back issue. In a 1995 order, the Commission held that the price cap rules have all along implicitly included an add-back requirement, explaining that it never "intended to eliminate the [add-back] requirement," and that add-back is "essential" to carrying out the "intended purpose" of the price cap mechanism.[4] The Court of Appeals affirmed, noting that the Commission's construction of its own rules and orders (which is, of course, entitled to substantial deference) is that "the add-back rule had been implicit in the [price cap] sharing rules from the beginning."[5] The Commission should, accordingly, rule in these tariff investigations that the price cap LECs that failed to reflect add-back in their 1993 and 1994 tariffs must recalculate their returns and sharing obligations for those years and refund the difference.

The Commission seeks comment on whether such a finding would violate the prohibition against retroactive rulemaking.[6] The rule against retroactive ratemaking has no application here. This proceeding is part of the Commission's investigation of the LECs' 1993 and 1994 tariffs. Congress expressly authorized the Commission to order "retroactive" refunds in tariff proceedings where, as here, the Commission has suspended the rates and put the carriers on express notice that their right to collect the rates prior to any determination of lawfulness is subject to refund obligations if the rates are ultimately determined to be unlawful. *See* 47 U.S.C.

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[4] Report and Order, *Price Cap Regulation of Local Exchange Carriers; Rate of Return and Lower Formula Adjustment*, 10 FCC Rcd. 5656, ¶ 32 (1995) ("*1995 Add-Back Order*").

[5] *Bell Atlantic,* 79 F.3d at 1202.

[6] *Notice* at 5.

§ 204. Thus, as demonstrated below, it is black letter law that, whatever the Commission's authority in a generic rulemaking, the Commission can, as part of *these* tariff investigations apply its rules, including the add-back requirement that the Commission determined has always been part of those rules. Indeed, if it were necessary to do so, the Commission could, in this tariff investigation clarify (or even modify) its rules to address the price cap orders' silence on add-back and require refunds of rates that were suspended consistent with the application of the clarified (or modified) rules. Thus, it is well within the Commission's authority to clarify in these tariff investigations that its price cap rules have always included an add-back requirement and to require all LECs to apply add-back in their 1993 and 1994 rates and, where there was a failure to apply add-back, to refund the more than $55 million by which those LECs inflated rates by failing to apply add-back.[7]

The price cap LECs that failed to apply add-back in their 1993 and 1994 interstate access tariffs will undoubtedly attempt to protect their over-earnings by rehashing their claims that they were not authorized to apply those rules in 1993 and 1994 because the Commission's price cap orders did not *explicitly* endorse add-back. But if (contrary to fact and the Commission's *1995 Add-back Order*) price cap LECs were not authorized to implement the add-back rules in 1993 and 1994, that would simply mean that a different set of LECs must make refunds. If the price cap LECs were not authorized to implement the price cap rules in the 1993 and 1994 interstate access tariffs, then the two LECs (NYNEX and SNET) that *did* implement those rules must be

[7] *See* Exhibit 1 (attached). This amount reflects the refunds that would be owed by the Regional Bell Operating Companies ("RBOCs"). Additional refunds would be owed by other LECs that failed to compute returns using add-back. Those LECs are listed in Exhibit 3 (attached).

ordered to refund the $37.7 million in additional earnings they received as a result of applying add-back.[8]

Perhaps there could be rational debate about whether LECs were always required to comply with the add-back requirement (in which case more than $55 million in refunds are due) or had no authorization in 1993 and 1994 to modify their calculated returns with add-back (in which case $37.7 million in refunds are due). But there can be no serious claim that *no* refunds are due. There is no lawful interpretation of the Commission's rules that would permit the LECs to have it both ways and to apply add-back only when it would increase rates. As the LECs themselves explained to the Commission, the price cap rules have always required "symmetrical treatment," and a "bifurcated" rule that permitted the application of add-back in some instances but not in others is plainly "unlawful."[9]

BACKGROUND

Prior to January 1, 1991, the LECs were subject to "rate-of-return" regulation, whereby the LECs' interstate access rates were set to target a prescribed rate-of-return. If a LEC earned a return that exceeded the prescribed maximum, the LEC was generally required to refund those over-earnings to ratepayers either through direct payments to ratepayers, rate reductions in subsequent tariff periods, or through awards in damages claims.[10] To the extent that refunds were paid in subsequent tariff periods, a question arose as to whether LECs could account for those refund amounts when computing returns in those subsequent tariff periods.

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[8] *See* Exhibit 2 (attached).

[9] *1995 Add-Back Order* n. 41; Ameritech Reply at 3; BellSouth Reply at 12; Bell Atlantic Reply at 4; GTE Reply at 11 (all filed in CC Docket No. 93-179 on Sept. 1, 1993).

[10] *See* 47 C.F.R. §§ 65.100-830; 1995 *Add-Back NPRM* ¶¶ 5-6.

An example illustrates the issue: If a LEC earned $100 in excessive returns in period 1, the LEC might be required to refund that amount to ratepayers in period 2. This refund would have the effect of reducing the LEC's period 2 earnings by $100. The issue, then, is whether the LEC is permitted to reflect that $100 in reduced period 2 earnings when computing period 2 returns. The Commission reasoned that because the $100 was paid by the LECs for over-earnings in period 1, the LEC should not be permitted to reduce its period 2 earnings by that amount.[11] If the $100 were not "added back" to period 2 earnings, the LEC would report that it earned $100 less than it *actually* earned in period 2, resulting in understated rate-of-return estimates for period 2. And because period 3 return requirements are based, in part, on reported period 2 returns, the LEC's period 3 return requirements would be inaccurately computed as well. Accordingly, the Commission's rules have long required LECs to "add back" the $100 to its period 2 earnings when computing the LEC's period 2 returns.[12]

In the *1990 Price Cap Order* and the *1991 Price Cap Reconsideration Order*,[13] the Commission adopted a new regulatory approach – the "price cap" mechanism – whereby the Commission regulates the maximum prices that LECs can charge for baskets of interstate access services rather than the maximum rates-of-return they can earn. As part of the price cap mechanism, the Commission recognized that the maximum prices (the "price cap index" or "PCI") should be periodically adjusted to account for efficiency gains (or losses).[14] To account

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[11] *See 1993 Add-Back NPRM* ¶¶ 5-6.

[12] *Id.*

[13] *See* Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786 (1990) ("*1990 Price Cap Order*"); Order on Reconsideration, *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd. 2691 (1991) ("*1991 Price Cap Reconsideration Order*).

[14] *See 1990 Price Cap Order* ¶¶ 120-165; *1991 Price Cap Reconsideration Order* ¶¶ 95-121.

for these efficiencies, the Commission adopted an "x-factor." The x-factor automatically reduces price-cap carrier's PCIs each year. However, the Commission recognized that the generic x-factor may not accurately reflect the actual efficiencies obtained by particular LECs. Therefore, the Commission adopted a "backstop" mechanism to further adjust PCIs where the x-factor adjustments were determined to be insufficient. One of the key indicators that a LEC has experienced efficiency gains or losses that are not sufficiently addressed by the x-factor is the LEC's rate-of-return.[15] If a LEC earns a substantial return under a particular set of PCIs, the LEC is presumed to have enjoyed corresponding efficiency gains that were not accounted for by the x-factor and that warrant a reduction in the PCIs ("sharing").[16] If a LEC earns very low returns under a particular set of PCIs, the LEC is presumed to have suffered efficiency losses, warranting an increase in its PCIs ("low-end adjustment").[17] Therefore, even under the price cap mechanism, LECs are required to compute rates-of-return for the purpose of determining whether the LEC is subject to sharing or low-end adjustments. To implement these rate-of-return "backstop" mechanisms, the Commission imported many of the same rules used for computing returns under its rate-of-return regulations.[18]

The Commission's price cap orders, however, did not expressly mention whether the add-back component of the rate-of-return regulations should be applied when computing rates-of-

[15] *See 1990 Price Cap Order* ¶¶ 120-129.

[16] *See id.*

[17] *See id.* ¶ 127.

[18] *See, e.g., id.* ¶ 373; *1993 Add-Back NPRM* ¶ 8. The FCC has since eliminated sharing as a feature of price-cap regulation. *See Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd. 16642 (1997).

return under the price cap mechanism.[19] This led to a dispute among the LECs. The LECs that earned very high returns and, hence, were subject to sharing requirements, did not apply the add-back rules in their 1993 and 1994 tariffs. These LECs argued that, because the Commission's price cap orders did not specifically mention the add-back rules, those rules were omitted (*sub silentio*) from the price cap rules, and LECs were not permitted to use add-back to compute interstate access rates.[20] On the other hand, the LECs that earned very low returns under the price cap mechanism and, hence, were permitted to make low-end adjustments, claimed that the Commission's price cap order, although silent on the add-back issue, implicitly adopted the add-back requirement.[21] Add-back, of course, benefits these LECs by decreasing computed regulatory earnings (because the low-end adjustment "subsidies" were removed from their earnings before calculating returns), resulting in increased authorized interstate access rates.[22] Simply put, the LECs that could charge higher interstate access rates without add-back claimed that the price cap rules did not incorporate the add-back requirement, and the LECs that could charge higher rates interstate access rates with add-back claimed that the price cap rules did incorporate the add-back requirement.

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[19] *1995 Add-Back Order* ¶ 15. Under the price cap mechanism, add-back works as follows: In period 1, a price cap LEC computes and reports its estimated rate-of-return under the current PCI. If those returns are above prescribed levels, then the LEC reduces its PCI in period 2 in order to "share" those over-earnings with ratepayers (to account for presumed efficiencies enjoyed by the LEC). To compute period 2 earnings, the LEC "adds-back" any reductions to its period 2 earnings that resulted from the period 1 sharing requirement. The add-back rules work analogously for low-end adjustments.

[20] *1995 Add-Back Order* ¶ 11 ("[s]ome of the price cap LECs proposed that the earnings levels used to compute sharing and low-end adjustments to be implemented in 1993 should include the effects of the sharing and low-end adjustment for 1992, without the add-back adjustments. . . . Other LECs proposed to adjust their earnings to include the amount associated with the add-back adjustment.").

[21] *See id.*

[22] *See id.*

Thus, in their 1993 and 1994 tariffs, the LECs (NYNEX and SNET) that could charge higher interstate access rates by computing sharing and low-end adjustments using the add-back rules filed tariffs that reflected add-back; the LECs (*e.g.,* Ameritech, Bell Atlantic, BellSouth, Nevada Bell, and Pacific Bell) that could charge higher interstate access rates by computing sharing and low-end adjustments without using add-back filed tariffs that did not reflect add-back.[23] In this way, the LECs effectively transformed the add-back rules from a mandatory tool to ensure accurate rate-of-return computation into an optional tool to be applied in a manner that maximized interstate access rates.

Ratepayers, including AT&T, objected to this perverse application of add-back.[24] The Commission's price cap rules either incorporated an add-back requirement (which made add-back mandatory for *all* LECs), or they did not (in which case no LEC was authorized to modify its return calculations with add-back). But, as AT&T pointed out, the price-cap orders could not possibly be construed as creating a new rule that allowed LECs unilaterally to choose whether to apply add-back, depending on which method resulted in the highest rates.[25]

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[23] *See* Memorandum Opinion And Order Suspending Rates And Designating Issues For Investigation, *1993 Annual Access Tariff Filings; National Exchange Carrier Association Universal Service Fund Lifeline Assistance Rates (Transmittal No. 556); GSF Order Compliance Filings; Bell Operating Companies' Tariff for the 800 Service Management System and 800 Data Base Access Tariffs*, CC Docket Nos. 93-193, 93-123, 93-129; DA 93-762, ¶ 32 (rel. June 23, 1993) ("*1993 Add-Back Suspension Order*"); Memorandum Opinion and Order Suspending Rates, *1994 Annual Access Tariff Filings; National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates*, 9 FCC Rcd. 3705, ¶ 12 (1994) ("*1994 Add-Back Suspension Order*").

[24] *See, e.g.,* Petition of American Telephone and Telegraph Company, *1993 Annual Access Tariff Filings*, at 20-24 (filed April 27, 1993); Petition of MCI, *1993 Annual Access Tariff Filings,* at 21-24 (filed April 27, 1993); Petition of American Telephone and Telegraph Company, *1994 Annual Access Tariff Filings*, at 3-4 (1994). The over-earnings are summarized in Exhibits 1 & 2 (attached).

[25] *See, e.g.,* AT&T 1993 Opposition to Direct Cases at n. 51 (CC Docket 93-193, filed August 25, 1993).

On June 18, 1993, the Commission issued the *1993 Add-Back NPRM* proposing to amend its price cap rules expressly to require all LECs to compute returns using add-back. Five days later, on June 23, 1993, the Commission suspended the LECs' interstate access tariffs that took inconsistent positions on add-back, and set those tariffs for investigation. In so doing, the Commission noted that the issue was "being addressed in [the *1993 Add-Back NPRM*]" which "would clarify the LEC price cap rules to require that price cap LECs compute their rates of return for the price cap sharing and low-end adjustment mechanism in basically the same manner as rate of return carriers do in determining overearnings."[26] In 1994, the LECs again filed tariffs that inconsistently applied add-back to maximize interstate access rates.[27] The Commission suspended those rates and rolled the investigation of those tariffs into the ongoing investigation of the LECs' 1993 tariffs.[28]

On April 14, 1995, the Commission formally adopted the rule it proposed in the *1993 Add-Back NPRM*. The Commission concluded that it would "amend [its] rules to include an express requirement that price cap LECs make an analogous 'add-back' adjustment to their interstate revenues when calculation earnings used to determine sharing and low-end adjustments."[29] The Commission recognized that the add-back requirement was already implicit in the price cap rules and order. The Commission explained that "the add-back adjustment is essential if the sharing and low-end adjustments of the LEC price cap plan are to achieve their intended purpose" and that it never "intended to eliminate the [add-back rules] . . . for the

[26] *1993 Add-Back Suspension Order* ¶ 32.

[27] *See 1994 Add-Back Suspension Order* ¶ 12.

[28] *See 1993 Add-Back Suspension Order* ¶ 32; *1994 Add-Back Suspension Order* ¶ 12.

[29] *1995 Add-Back Order* ¶ 4.

purpose of calculating current returns [under the price cap plan]."[30] Accordingly, the Commission "clarified" its price cap rules by "adopt[ing] a rule explicitly incorporating the add-back process into the LEC price cap plan."[31] In affirming the *1995 Add-Back Order,* the Court of Appeals noted that, according to the Commission's own construction of its price cap orders, the "add-back rule had been implicit in the sharing rules from the beginning."[32] Despite these findings, however, the Commission ordered LECs to compute interstate access rates using the add-back rules on a prospective basis only,[33] and declined to decide the question pending in the tariff proceedings "whether the add-back adjustment is required for purposes of the 1993 and 1994 Annual Tariff Filings."[34] The Commission reasoned that the judicial doctrine prohibiting retroactive rulemaking prevented it from making any retroactive determinations in the generic rulemaking proceeding.[35]

The Commission has taken no action in the 1993 and 1994 tariff investigations. The LECs' rate-maximizing application of the add-back rules in 1993 and 1994 therefore remains unremedied.

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[30] *Id.* ¶¶ 32, 56.

[31] *Id.* ¶ 16.

[32] *Bell Atlantic*, 79 F.3d at 1202.

[33] *1995 Add-Back Order* ¶ 49.

[34] *Id.* ¶ 3, n.3.

[35] *Id.* ¶ 49 ("[w]e agree with commenters that the explicit add-back rule adopted here may, as a legal matter, be applied only on a prospective basis" because retroactive application may violate the rule against "retroactive rulemaking").

ARGUMENT

I. THE 1993 AND 1994 TARIFFS OF LECS THAT FAILED TO COMPUTE THEIR RETURNS WITH ADD-BACK ARE UNLAWFUL.

The Commission already has resolved the central issue in this case: All LECs were required to compute interstate access rates using add-back in their 1993 and 1994 tariffs. In the *1995 Add-Back Order*, the Commission "*clarified*" that its existing price cap rules have all along required LECs to compute interstate access rates using the add-back rules.[36] The Commission explained that, in its price cap orders, it "did not intend[] to eliminate the requirement [add-back rules] for the purpose of calculating current returns."[37] On the contrary, the Commission explained that "add-back adjustments are *necessary* to achieve fully the purpose of the sharing and low-end adjustment mechanisms."[38] "Without this adjustment . . . the sharing and low-end adjustments would not operate as [the price cap order] intended."[39] The Court of Appeals affirmed the Commission's reasoning, expressly noting that the Commission had concluded that the "add-back rule had been implicit in the sharing rules from the beginning."[40]

This should be the end of the argument. Pursuant to § 204 of the Act, 47 U.S.C. § 204, the Commission suspended the LECs' 1993 and 1994 tariffs, ordered an accounting, and set them for investigation to determine whether those tariffs properly reflected add-back.[41] The Commission has definitively ruled that an add-back requirement was always implicit in its rules and thus LECs were in fact required in 1993 and 1994 to apply add-back to compute returns for

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[36] *1995 Add-Back Order* ¶ 15.

[37] *Id.* ¶ 32.

[38] *Id.* ¶ 50; *see also id.* ¶ 56 ("the add-back adjustment is essential if the sharing and low-end adjustments of the LEC price cap plan are to achieve their intended purpose").

[39] *Id.* ¶ 50.

[40] *Bell Atlantic*, 79 F.3d at 1202.

[41] *1993 Suspension Order* ¶ 32; *1994 Suspension Order* ¶ 12.

purposes of establishing interstate access rates. Thus, the Commission should promptly conclude its investigation of the LECs' 1993 and 1994 tariffs by ordering refunds to ratepayers for the excessive earnings reaped by the LECs that failed to apply add-back in those 1993 and 1994 tariffs.

But even if (contrary to the *1995 Add-Back Order*) the price cap orders did not implicitly require the LECs to continue to apply add-back in calculating returns, the Commission can in *this* proceeding find that the LECs' 1993 and 1994 tariffs must reflect add-back. The Commission has ample authority to do so. It is black letter law that "a tariff investigation is a rulemaking"[42] under the APA, that the Commission can and does "routinely make[] significant policy and methodological decisions based on the records developed in tariff investigations[,] and [that] such decisions do not violate the notice and comment requirements of the [APA]."[43] And, as detailed below, the Act expressly permits the Commission to order refunds for rates that fail to comply with rule clarifications or modifications that result from such tariff investigations.[44]

There is no non-arbitrary basis for the Commission to refuse to find unlawful the tariffs of the LECs that did not apply add-back in 1993 and 1994. A Commission decision in these tariff investigations that permitted LECs to opt-out of the add-back requirement in their 1993 and 1994 tariffs would result – according to the Commission's own orders – in interstate access rates that are inconsistent with the intended purpose of the price cap mechanism. Thus, the only non-

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[42] *See, e.g.,* Memorandum Opinion and Order, *Tariffs Implementing Access Charge Reform*, 13 FCC Rcd. 14683, ¶ 81 (1998) ("*Access Reform Tariff Order*") (quotation omitted); Memorandum Opinion and Order, *Investigation of Special Access Tariffs of Local Exchange Carriers*, 5 FCC Rcd. 4861 (1990); 5 U.S.C. § 551(4).

[43] *Access Reform Tariff Order* ¶ 80.

[44] 47 U.S.C. § 204(a).

arbitrary finding in this proceeding is that all LECs were required to apply add-back in their 1993 and 1994 tariffs, and that the LECs (*e.g.,* Ameritech, Bell Atlantic, BellSouth and Nevada Bell, and Pacific Bell) that did not do so must now refund to ratepayers the more than $55 million in over-earnings that resulted from their failure to apply add-back.

II. THE RULE AGAINST RETROACTIVE RATE-MAKING IS NOT APPLICABLE HERE.

The Commission seeks comment on whether enforcing its add-back rules against the LECs' 1993 and 1994 tariffs is prohibited by the rule against retroactive ratemaking. The LECs, in order to avoid refunds, will claim that the Commission's statement in the *1995 Add-Back Order* (¶¶ 48-49) that the Commission could not, consistent with the rule against retroactive ratemaking, determine *in that generic rulemaking proceeding* that the LECs' 1993 and 1994 tariffs were unlawful means that the Commission cannot do so in *these tariff investigation proceedings*. That argument is specious. To be sure, like the generic rulemaking that resulted in the *1995 Add-Back Order*, this tariff investigation is a rulemaking, in which the Commission can modify or clarify its rules.[45] However, Congress has expressly authorized the Commission to order "retroactive" refunds pursuant to tariff investigations where, as here, the Commission has suspended the rates and put the carriers on express notice that their right to collect the rates prior

[45] As explained by the Commission, "[a] tariff investigation is a rulemaking" under the APA, that the Commission can and "routinely makes significant policy and methodological decisions based on the records developed in tariff investigations[,] and [that] such decisions do not violate the notice and comment requirements of the [APA]." *See, e.g.,* Memorandum Opinion and Order, *Tariffs Implementing Access Charge Reform*, 13 FCC Rcd. 14683, ¶¶ 80-81 (1998) ("*Access Reform Tariff Order*") (internal quotation omitted); Memorandum Opinion and Order, *Implementation of Special Access Tariffs of Local Exchange Carriers*, 5 FCC Rcd. 4861 (1990); 5 U.S.C. § 551(4).

to any determination of lawfulness is subject to refund obligations if the rates are ultimately determined to be unlawful.[46] As explained by the Commission,

> [a]lthough Section 204(a) proceedings are rulemakings of particular applicability, . . . the Commission's authority under the section is not limited to a prospective determination of the lawfulness of rates. Rather, as a tradeoff for permitting rates under investigation to go into effect, Section 204(a) specifically authorizes the Commission to order refunds at the conclusions of such a proceeding if such relief is appropriate. Thus, it is obvious from the nature of the statutory scheme, and from the fact that this proceeding was commenced through a Designation Order rather than a Notice of Proposed Rulemaking, that any conclusions this Commission reached with respect to the lawfulness of strategic pricing would be applied to the rates that took effect subject to the investigation, and that the Commission would exercise its statutory authority to determine whether a refund was appropriate.[47]

Accordingly, it is well within the Commission's authority to clarify (or even modify) its price cap rules in these 1993 and 1994 tariff investigations to require all LECs to apply add-back in their 1993 and 1994 tariffs, and to require LECs to refund to ratepayers any over-earnings that occurred while the unlawful tariffs were in effect.

It would indeed be absurd if the Commission lacked authority to order refunds based on clarifications of existing rules (or even new rules) developed in ongoing tariff investigations. The opposite rule – *i.e.,* that the Commission could not order refunds – would establish an entirely one-sided system that would unlawfully and systematically favor LECs. The LECs would be able immediately and unreasonably to incorporate all slightly ambiguous interstate access rules in a manner favorable to them, while ignoring all ambiguities that are unfavorable to

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[46] *See* 47 U.S.C. § 204. It is black letter law that Congress can, as it did here, authorize retroactive rulemaking. *See, e.g., Bowen* v. *Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1998) (explaining that an agency may retroactively apply rules if "that power is conveyed by Congress").

them. And ratepayers would be forced to pay those rates. In effect, every time that an ambiguity arose in the Commission rules – and no set of rules, no matter how comprehensive, can anticipate everything – the LECs would be able to inflate interstate access rates for at least one year, with no risk of having to pay refunds. It is not surprising, therefore, that such an approach is not consistent with the Act and has been properly been rejected by the Commission.

III. IN THE ALTERNATIVE, IF LECS WERE NOT AUTHORIZED TO REFLECT ADD-BACK IN THEIR 1993 AND 1994 TARIFFS, THEN NYNEX AND SNET MUST BE ORDERED TO PAY REFUNDS TO RATEPAYERS.

The LECs that failed to apply add-back in their 1993 and 1994 tariffs undoubtedly will rehash their claims that the price cap orders' silence on add-back prior to the *1995 Add-Back Order* means that LECs were not authorized to compute interstate access rates using add-back. As noted, that argument is wrong – although add-back was not expressly mentioned in the 1990-91 price cap orders, the add-back requirement was not repealed, and, as the *1995 Add-Back Order* found, add-back was always *implicitly* required.[48] However, even assuming *arguendo* that the LECs were not authorized to compute interstate access rates using the add-back mechanism, the Commission still must promptly order refunds from a different set of LECs, *i.e.,* the LECs that did apply add-back in their 1993 and 1994 tariffs. As noted, NYNEX and SNET determined

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[47] Memorandum Opinion and Order, *Implementation of Special Access Tariffs of Local Exchange Carriers*, 5 FCC Rcd. 4861, ¶ 7 (1990).

[48] Prior to the price cap orders, add-back was *mandatory* for *all* LECs. The Commission, therefore, could not lawfully have adopted a different rule in its price cap orders, particularly one that is diametrically opposed (no add-back or optional add-back, rather than mandatory add-back) without providing a "reasoned explanation" for that decision. *Motor Vehicle Mfrs Ass'n. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983) (when an agency changes a settled policy or course of behavior it "is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance"). The price cap orders, however, do not even mention the add-back rules, and certainly do not provide a reasoned explanation for reversing those rules. Thus, to assume that the Commission silently repealed the add-back requirement or made it optional is to assume that the Commission acted arbitrarily and unlawfully.

that they could implement higher interstate access rates by applying add-back in their 1993 and 1994 tariffs and filed interstate access rates that were computed using add-back. Therefore, if the Commission determines that the price cap orders did not authorize the LECs to apply add-back prior to 1995, then NYNEX and SNET must be ordered to refund the $37.7 million in excess earnings that they recovered from ratepayers as a direct result of applying the add-back rules.[49]

IV. THERE IS NO LAWFUL BASIS FOR ALLOWING THE LECS TO INCONSISTENTLY APPLY ADD-BACK IN THEIR 1993 AND 1994 TARIFFS.

Although the LECs may debate about whether they were required to comply with the add-back requirement (in which case more than $55 million in refunds are due) or had no authorization in 1993 and 1994 to modify their calculated returns with add-back (in which case $37.7 million in refunds are due), there can be no serious claim that the Commission's rules permitted the LECs to have it both ways and to apply add-back only when it increased rates. Both the LECs and the Commission have expressly rejected such a "bifurcated" approach to add-back as plainly unlawful. In response to the *1993 Add-Back NPRM*, Ameritech explained that "sharing and the lower formula adjustment are in reality two sides of the same coin," they "were implemented . . . in order to allow for the fact that a single, industry-wide productivity offset was used for all price cap LECs and that that figure might be understated or overstated in any given year."[50] Ameritech thus concluded that "[t]his fact requires that both sharing and [low-end adjustments] be treated the same for add back purposes."[51] Likewise, BellSouth explained that "[t]he Commission clearly intended that the two backstop mechanisms, sharing and lower

[49] *See* Exhibit 2 (attached).

[50] Ameritech 1993 Reply at 3 (CC Docket No. 93-179, filed Sept. 1, 1993).

[51] *Id.*

formula adjustment, operate symmetrically."[52] Bell Atlantic explained that a "one-sided" mechanism would "ignore[] the theoretical underpinnings of the [sharing and low-end adjustment mechanisms]."[53] And GTE emphasized that an "asymmetric" rule would be "unlawful" and would "bear[] no resemblance to the Commission's balanced plan."[54] The Commission agreed with these LECs and rejected a "bifurcated" add-back adjustment, noting the LECs' statements that "both the sharing and low-end adjustment mechanisms were intended to compensate for unanticipated errors in the productivity offset and must be treated identically."[55]

It is thus clear that the purpose of the add-back requirements – to ensure accurate computations of interstate access rates – can be served only if they are applied consistently for all LECs. An optional add-back rule, or an add-back rule that applies only to LECs with prior period low-end adjustment obligations, serves no legitimate purpose. It would only allow LECs artificially to inflate their interstate access rates. And, as noted, that is exactly what happened in 1993 and 1994. None of the LECs with sharing obligations in 1992 or 1993 applied add-back, which allowed them to seek interstate access rates that were more than $55 million higher than if they had applied add-back, and NYNEX and SNET, which were eligible for low-end adjustments in 1992 and 1993, applied add-back, allowing them to seek interstate access rates that were $37.5 million higher than if they had not applied add-back.[56]

This arbitrary application of the add-back rules plainly violates the Communications Act. The Act requires that "*[a]ll* charges . . . and regulations for and in connection with . . .

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[52] BellSouth 1993 Reply at 12 (CC Docket No. 93-179, filed Sept. 1, 1993).

[53] Bell Atlantic 1993 Reply at 4 (CC Docket No. 93-179, filed Sept. 1, 1993).

[54] GTE 1993 Reply at 11 (CC Docket No. 93-179, filed Sept. 1, 1993).

[55] *1995 Add-Back Order* n. 41.

[56] *See* Exhibits 1 & 2 (attached).

communications service . . . shall be just and reasonable." 47 U.S.C. § 201(b) (emphasis added). Any charge or regulation that is "unjust or unreasonable is . . . unlawful." *Id.*[57] Commission precedent and the LECs' own admissions confirm that the price cap rules can satisfy their intended purpose only if add-back is complied consistently, and any Commission order endorsing the LECs' attempts to have it both ways would plainly result in unjust and unreasonable rates in violation of the Act.

Unsurprisingly, the courts have consistently rejected this type of "head I win, tails you lose" approach to ratemaking, explaining that "assigning the [regulated] firm the benefit of good outcomes and customer[] [ratepayers] the burden of bad ones" provides the regulated utility with "unhealthy incentive[s]."[58] Indeed, where a regulatory scheme permits a regulated entity to unilaterally assign costs to ratepayers "the potential for abuse is apparent" and, in such circumstances there is "[n]o protection . . . [for] ratepayer."[59] The LECs perverse interpretation and application of add-back, which permits them to assign bad outcomes to ratepayers, without providing the ratepayers any protections, is therefore exactly the type of ratemaking approach that the courts have rejected.

[57] The Commission has a "duty to execute and enforce the provisions of the Communications Act," the Commission must ensure that Bell rates for access services are "just, fair, reasonable and nondiscriminatory." *See, e.g., American Tel. & Tel. Co.* v. *FCC.,* 572 F.2d 17 (2nd Cir. 1978).

[58] *Williston Basin Interstate Pipeline Company* v. *FERC*, 115 F.3d 1042, 1044 (D.C. Cir. 1997).

[59] *Natural Pipeline Gas Co. of America* v. *FERC*, 765 F.2d 1155, 1162 (D.C. Cir. 1985).

CONCLUSION

For the foregoing reasons, the Commission should find unlawful the 1993 and 1994 tariffs of LECs that failed to apply add-back and require those LECs to make refunds. Alternatively, the Commission should find unlawful the 1993 and 1994 tariffs of LECs (NYNEX and SNET) that applied add-back and require those LECs to make refunds.

Respectfully submitted,

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May 5, 2003

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Comments of AT&T Corp. was served, by the noted methods, the 5th day of May, 2003, on the following:

Marlene H. Dortch
Office of the Secretary
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By Electronic Filing

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/s/ Peter M. Andros
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Additional Annual Filing Sharing After Adding-Back Exhibit 1
RBOCs Previous Year's Annual Filing Sharing Page 1 of 2
(Dollars in Thousands) Summary

1993 Annual Filing

	A	B	C	D	E = D - C
	1992 ROR Filed	1992 ROR w/Sharing Add-back	1993 AF Sharing Filed	1993 AF Sharing w/Add-Back	Additional Sharing From Higher ROR
Ameritech	12.79%	12.99%	$13,977	$19,836	$5,859
Bell Atlantic	12.48%	12.66%	$7,709	$14,883	$7,174
Bell South	13.03%	13.19%	$11,444	$18,374	$6,930
Nevada Bell	15.53%	15.67%	$1,962	$2,180	$218
TOTAL					**$20,181**

1994 Annual Filing

	A	B	C	D	E = D - C
	1993 ROR Filed	1993 ROR w/Sharing Add-back	1993 AF Sharing Filed	1993 AF Sharing w/Add-Back	Additional Sharing From Higher ROR
Ameritech	14.80%	15.15%	$67,041	$78,072	$11,031
Bell Atlantic	13.89%	14.14%	$55,550	$68,010	$12,460
Bell South	13.72%	13.97%	$40,207	$50,529	$10,322
Pacific Bell	12.85%	12.90%	$13,344	$14,417	$1,073
Nevada Bell	17.33%	18.44%	$2,948	$3,405	$457
TOTAL					**$35,343**

GRAND TOTAL **$55,524**

Note: This chart includes only those LECs (the RBOCs) who will have a change in their 1993 and 1994 Annual Filing Sharing Exogenous Cost when required to addback their previous years Sharing. A complete list of all LECs/cosas whose 1993 and 1994 Sharing/LFA will be impacted as a result of add-back is shown in Exhibit 3.

Impact of RBOCs Computing Rate Of Return And Sharing Calculations With Add-Back

From: 01/01/92 To: 12/31/92	Ameritech			Bell Atlantic			Bell South			Nevada Bell			
FCC 492A First report	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference	
1. Total Revenues	$2,096,755	$2,105,850	$9,095	$2,637,546	$2,648,637	$11,091	$2,922,417	$2,934,060	$11,643	$50,422	$50,571	$149	
2. Total Expenses and Taxes	$1,712,362	$1,715,545	$3,183	$2,133,892	$2,137,774	$3,882	$2,317,852	$2,321,927	$4,075	$39,382	$39,434	$52	
3. Operating Income(Net Return)(Ln1-Ln2)	$384,393	$390,304	$5,911	$503,654	$510,863	$7,209	$604,565	$612,133	$7,568	$11,040	$11,137	$97	
4. Rate Base (Avg Net Invest)	$3,005,755	$3,005,755	$0	$4,034,959	$4,034,959	$0	$4,640,488	$4,640,488	$0	$71,087	$71,087	$0	
5. Rate of Return (Ln3/Ln4)	12.79%	12.99%	0.20%	12.48%	12.66%	0.18%	13.03%	13.19%	0.16%	15.53%	15.67%	0.14%	
6. Earnings for Sharing Adjustment (Ln4*(12.25%-Ln5)*50%		($11,050)			($8,290)			($10,235)			($1,214)		TOTAL 1993 AF Additional Sharing (Total Line 10 Diff Column)
7. FIT Gross-Up at 34% (Ln6*.34/.66)		($5,692)			($4,271)			($5,273)			($626)		
8. SIT Gross-Up (State Rate * Ln6+Ln7)		($1,088)			($816)			($1,008)			($120)		
9. Interest @ 11.25% (Ln6+Ln7+Ln8)*11.25%		($2,006)			($1,505)			($1,858)			($220)		
10. Total (Sharing)/LFA (Ln6+Ln7+Ln8+Ln9)	**($13,977)**	**($19,836)**	**($5,859)**	**($7,709)**	**($14,883)**	**($7,174)**	**($11,444)**	**($18,374)**	**($6,931)**	**($1,962)**	**($2,180)**	**($217)**	**($20,181)**

From: 01/01/93 To: 12/31/93	Ameritech			Bell Atlantic			Bell South			Pacific Bell			Nevada Bell			
FCC 492A First Report	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference	
1. Total Revenues	$2,169,383	$2,185,466	$16,083	$2,724,780	$2,739,725	$14,945	$3,007,176	$3,024,541	$17,365	$1,575,156	$1,576,976	$1,820	$51,731	$52,861	$1,130	
2. Total Expenses and Taxes	$1,726,599	$1,731,228	$5,629	$2,166,352	$2,171,583	$5,231	$2,372,397	$2,378,475	$6,078	$1,258,941	$1,259,578	$637	$40,161	$40,556	$395	
3. Operating Income(Net Return)(Ln1-Ln2)	$443,784	$454,238	$10,454	$558,428	$568,143	$9,715	$634,779	$646,066	$11,287	$316,215	$317,398	$1,183	$11,570	$12,304	$734	
4. Rate Base (Avg Net Invest)	$2,998,024	$2,998,024	$0	$4,019,372	$4,019,372	$0	$4,625,662	$4,625,662	$0	$2,461,226	$2,461,226	$0	$66,744	$66,744	$0	
5. Rate of Return (Ln3/Ln4)	14.80%	15.15%	0.35%	13.89%	14.14%	0.24%	13.72%	13.97%	0.24%	12.85%	12.90%	0.05%	17.33%	18.44%	1.10%	
6. Earnings for Sharing Adjustment (Ln4*(12.25%-Ln5)*50%		($43,490)			($37,885)			($28,147)		($7,357)	($7,949)			($1,897)		TOTAL 1994 AF Additional Sharing (Total Line 10 Diff Column)
7. FIT Gross-Up at 34% (Ln6*.34/.66)		($22,404)			($19,516)			($14,500)		($3,790)	($4,095)			($977)		
8. SIT Gross-Up (State Rate * Ln6+Ln7)		($4,283)			($3,731)			($2,772)		($847)	($915)			($187)		
9. Interest at 11.25% (Ln6+Ln7+Ln8)*11.25%		($7,895)			($6,877)			($5,110)		($1,349)	($1,458)			($344)		
10. Total (Sharing)/LFA (Ln6+Ln7+Ln8+Ln9)	**($57,041)**	**($78,072)**	**($11,031)**	**($55,550)**	**($68,010)**	**($12,460)**	**($40,207)**	**($50,529)**	**($10,322)**	**($13,344)**	**($14,417)**	**($1,073)**	**($2,948)**	**($3,406)**	**($458)**	**($35,343)**

Grand Total 1993 & 1994 AF Add! Sharing = ($55,524)

NYNEX and SNET Additional Annual Filing Sharing "Without" Adding-Back (Removing) Previous Year's Annual Filing LFA

(Dollars in Thousands)

1993 Annual Filing

	A	B	C	D	E = D - C
	1992 ROR Filed 'With' LFA Add-back	1992 ROR 'Without' LFA Add-back	1993 AF Sharing Filed 'With' Add-back	1993 AF Sharing 'Without' LFA Add-back	Additional Sharing From Higher ROR
NYNEX	12.30%	12.88%	$1,712	$21,404	$19,692
SNET	11.84%	12.69%	$0	$2,201	$2,201
TOTAL					**$21,893**

1994 Annual Filing

	A	B	C	D	E = D - C
	1993 ROR Filed 'With' LFA Add-back	1993 ROR 'Without' LFA Add-back	1994 AF Sharing Filed 'With' Add-back	1994 AF Sharing 'Without' LFA Add-back	Additional Sharing From Higher ROR
NYNEX	12.57%	13.05%	$11,173	$27,043	$15,870
SNET	11.39%	12.20%	$0	$0	$0
TOTAL					**$15,870**

GRAND TOTAL **$37,763**

IMPACT OF NYNEX AND SNET COMPUTING RATE OF RETURN AND SHARING CALCULATIONS "WITHOUT" ADD-BACK

1993 Annual Filing

From: 01/01/92 To: 12/31/92	NYNEX			SNET		
FCC 492A First report	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference
1. Total Revenues	$2,982,649	$3,017,988	$35,339	$312,072	$319,421	$7,349
2. Total Expenses and Taxes	$2,497,116	$2,509,797	$12,681	$251,946	$254,961	$3,015
3. Operating Income(Net Return)(Ln1-Ln2)	$485,533	$508,191	$22,658	$60,126	$64,460	$4,334
4. Rate Base (Avg Net Invest)	$3,947,104	$3,947,104	$0	$507,830	$507,830	$0
5. Rate of Return (Ln3/Ln4)	12.30%	12.88%	0.57%	11.84%	12.69%	0.85%
6. Earnings for Sharing Adjustment (Ln4*(12.25%-Ln5)*50%		($12,335)			($1,125)	
7. FIT Gross-Up at 34% (Ln6*.34/.66)		($6,355)			($580)	
8. SIT Gross-Up (State Rate * Ln6+Ln7)		($549)			($273)	
9. Interest @ 11.25% (Ln6+Ln7+Ln8)*11.25%		($2,164)			($223)	
10. Total (Sharing)/LFA (Ln6+Ln7+Ln8+Ln9)	**($1,712)**	**($21,404)**	**($19,692)**	**$0**	**($2,201)**	**($2,201)**

1994 Annual Filing

From: 01/01/93 To: 12/31/93	NYNEX			SNET		
FCC 492A First report	First Report Col A	Adjustment For Add Back	Difference	First Report Col A	Adjustment For Add Back	Difference
1. Total Revenues	$3,009,364	$3,038,305	$28,941	$326,892	$333,869	$6,977
2. Total Expenses and Taxes	$2,526,530	$2,537,229	$10,699	$270,094	$273,058	$2,964
3. Operating Income(Net Return)(Ln1-Ln2)	$482,834	$501,076	$18,242	$56,798	$60,811	$4,013
4. Rate Base (Avg Net Invest)	$3,840,041	$3,840,041	$0	$498,490	$498,490	$0
5. Rate of Return (Ln3/Ln4)	12.57%	13.05%	0.48%	11.39%	12.20%	0.81%
6. Earnings for Sharing Adjustment (Ln4*(12.25%-Ln5)*50%		($15,335)				
7. FIT Gross-Up at 34% (Ln6*.34/.66)		($8,258)				
8. SIT Gross-Up (State Rate * Ln6+Ln7)		($715)				
9. Interest @ 11.25% (Ln6+Ln7+Ln8)*11.25%		($2,735)				
10. Total (Sharing)/LFA (Ln6+Ln7+Ln8+Ln9)	**($11,173)**	**($27,043)**	**($15,870)**	**$0**	**$0**	**$0**

Exhibit 3

LECs (cosas) That Will Need to Re-compute Rate-Of-Return and Sharing/LFA if Required to Include Add-Back

1993 Annual Filing	1994 Annual Filing
Ameritech	Ameritech
Bell Atlantic	Bell Atlantic
Bell South	Bell South
Nevada Bell	Pacific Bell
Contel	Nevada Bell
COES	Vista
CONW	Contel
CONY	COAL
COPA	COAT
GTE	COAZ
GTAK	COCA
GTIM	COIL
GTIN	COIN
GTMI	COIT
GTMO	COKY
GTNA	COME
GTNE	COMN
GTOH	COMT
GTWI	CONC
Sprint	CONM
UTIN	CONV
UTMW	COOR
UTNW	COPT
UTOH	COSC
UTSE	COTX
	COVA
	COVT
	COWA
	COWZ
	GTE
	GAMI
	GTAK
	GTAR
	GTFL
	GTHI
	GTID
	GTMT
	GTNM
	GTOK
	GTTX
	GTWI
	Sprint
	UTEG
	UTFL
	UTIN
	UTMW
	UTNW
	UTOH
	UTSE